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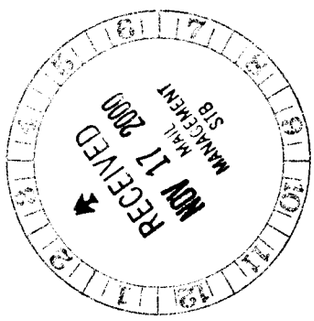

VIA HAND DELIVERY

The Hon. Vernon A. Williams
Secretary
Surface Transportation Board
Case Control Unit
Attn: STB Ex Parte No. 582 (Sub-No. 1)
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: Ex Parte No. 582 (Sub No. 1), Major Rail Consolidation Procedures

Dear Secretary Williams:

Enclosed for filing in the referenced proceeding are the original and 25 copies of the Comments of the State of New York in Response to Notice of Proposed Rulemaking. Also enclosed is a 3.5-inch diskette containing the text of this letter and the enclosed Comments in WordPerfect 8.0 format.

Please acknowledge receipt of the enclosed filing by stamping and returning the enclosed duplicate of this letter to our messengers.

Sincerely,

Kelvin J. Dowd

KJD/cbh
Enclosures

BEFORE THE
SURFACE TRANSPORTATION BOARD

In The Matter Of:	)	
MAJOR RAIL CONSOLIDATION PROCEDURES	)	**Ex Parte No. 582 (Sub-No. 1)**

COMMENTS OF THE STATE OF NEW YORK
IN RESPONSE TO NOTICE OF
PROPOSED RULEMAKING

OF COUNSEL:

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Dated: November 17, 2000

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BEFORE THE
SURFACE TRANSPORTATION BOARD

In The Matter Of:	)	
MAJOR RAIL CONSOLIDATION PROCEDURES	)	**Ex Parte No. 582 (Sub-No. 1)**

COMMENTS OF THE STATE OF NEW YORK
IN RESPONSE TO NOTICE OF
PROPOSED RULEMAKING

The State of New York, acting by and through the New York State Department of Transportation ("New York"), submits its Comments in response to the Notice of Proposed Rulemaking served by the Board in this proceeding on October 3, 2000.

INTRODUCTION

New York has been an active participant in this proceeding since its inception, first through the testimony of New York State Department of Transportation Assistant Commissioner John F. Guinan,[1] and more recently through initial Comments filed in response to the Advance Notice of Proposed

[1] Ex Parte No. 582, Public Views On Major Rail Consolidations, Comments of the State of New York, February 29, 2000, V.S. Guinan.

Rulemaking served by the Board on March 17, 2000.[2] Both summarized New York's direct interest in this proceeding and the history of its commitment to the development of a sound and economical surface transportation system. See, e.g., Comments at 4-5.

In its May Comments, New York proposed five (5) key reforms to the Board's current rail merger review policy guidelines, addressing issues such as (1) the promotion and expansion of rail-to-rail competition; (2) the coordination of freight and passenger operations; (3) the need for detailed before-the-fact service implementation plans; (4) the protection of shortline and regional railroad interests; and (5) the need for closer scrutiny of claimed merger benefits and measures to ensure that shippers and communities don't bear the burdens of merger-related inefficiencies and cost overruns. See Comments at 7. To varying degrees, each of these important policy reforms are addressed in the rules proposed in the Board's NPR. In these Comments, New York offers its views with respect to those rules, and the areas in which the rules as proposed might be improved to better serve the interests to which they are directed.

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[2] Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures, Comments of the State of New York, May 16, 2000 (hereinafter "Comments").

In the NPR, the Board describes its proposed new rules as "a paradigm shift in our review of major mergers." NPR at 10. New York agrees that a "paradigm shift" in the policies underlying the exercise of the Board's authority over rail merger and consolidation proposals is needed, and endorses the Board's own summary of the proper goals of the new regulatory scheme:

> While we have always used a balancing test, we are changing how we would weigh these goals and are adding new elements to the mix. We would upgrade the importance of competition. We would recognize that redundant capacity is no longer the issue it once was, and that improved carrier efficiency would not have the overriding priority in our balancing that it had before. We would give greater attention to the potential for transitional service harms. And we would place greater emphasis on the role of railroads (including Class II and III carriers) in the broader transportation infrastructure.

NPR at 12. In terms of the Board's specific proposed rules and rules changes, New York offers the following recommendations:

1. Proposed Sections 1180.1(c)(2) and 1180.1(d) should be modified and clarified to ensure that the Board's pro-competitive intent can be fulfilled effectively and meaningfully.

2. The new rule addressing passenger-freight rail relationships (proposed Section 1180.10(b)) should be adopted with minor clarifications to ensure its applicability in all appropriate circumstances.

3. The new rule set out in proposed Section 1180.10 (Service Assurance Plan) should be adopted in full, with no weakening modifications.

4. The rules governing transaction impacts on smaller railroads (e.g., proposed Section 1180.1(c)(2)(ii)) should be expanded to better protect the interests of shortlines and regional railroads.

5. The Board should add firm enforcement terms to the new rule providing for closer scrutiny of claimed future merger benefits (proposed Section 1180.1(c)(1)).

Each of the foregoing is discussed more fully, below.

COMMENTS OF THE STATE OF NEW YORK

I. THE BOARD'S PROPOSED RULE FAVORING ENHANCED COMPETITION SHOULD BE MODIFIED AND CLARIFIED

Given the already highly-concentrated state of the railroad industry, the preservation and enhancement of rail-to-rail competition represents perhaps the greatest challenge faced by the Board in considering any new mergers or major consolidation transactions. A recognition of this challenge is apparent in the Board's comments throughout the NPR, which acknowledged the need "to give increased emphasis to the public benefits that flow from enhanced competition...." NPR at 14. In principle, this acknowledgment is consistent with the position advanced by New York in its initial Comments. See Comments at 7-9. New York is concerned, however, that the rules proposed by the Board to foster this critically important public interest may be inadequate as drafted.

In the NPR, the Board proposes to rely in the first instance on applicant carriers to "mitigate and offset competitive harms" that otherwise would result from new mergers or consolidations. NPR at 14 (proposed Section 1180.1(c)(2)). While the Board virtually assumes that any new transaction will threaten competition, its initial response is to defer to the carriers themselves:

> [T]he Board expects that any merger of Class I carriers will create some anti-competitive effects that are difficult to mitigate through appropriate conditions, and that transitional service disruptions may temporarily negate any shipper benefits. Therefore, to offset these harms, applicants will be required to propose conditions that will not simply preserve but also enhance competition.

NPR at 16 (proposed Section 1180.1(d)). New York appreciates that the proposed new rule advances the status quo insofar as the promotion of competition is concerned. New York respectfully submits, however, that to bring the actual impact and effect of the rule closer to the acknowledged public policy goal of preserved and enhanced competitive options for shippers and communities, at least three (3) modifications and/or clarifications are needed.

First, the Board should amend the proposed rule to affirm that applicants' proposed remedial measures will not carry any presumption of superiority to conditions proposed by

affected, interested parties, particularly shippers or public authorities. As is clear from past transactions before the Board, the view of a merger applicant as to the effectiveness of a competitive remedy that it has agreed to offer a shipper or region often is not shared by those who are supposed to benefit from that remedy.[3] In considering prospective enhancements to competition as an offset to "anti-competitive effects that are difficult to mitigate through appropriate conditions,"[4] the Board should state clearly its intent to consider all alternatives on an equal footing, and not defer automatically to an applicant carrier's voluntary plan.

Second, New York requests that the Board clarify its proposed Section 1180.1(d) to confirm that carrier parties to future mergers will not be given a license to reduce or eliminate competition in one region or market, so long as they "enhance competition" in another region or market as an offset. New York acknowledges that the Board looks with disfavor on conditions that would compensate a party that claims to be "disadvantaged" by increased competition elsewhere. NPR at 16. Where, however, a party or region is threatened with a reduction in or

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[3] See, e.g., Finance Docket No. 33388, CSX Corp., Et Al. -- Control and Operating Leases/Agreements -- Conrail Inc., Et Al., Decision served July 23, 1998 at 81-84.

[4] NPR at 16.

elimination of competition, the right to seek redress through appropriate conditions should not be compromised by a carrier's offer to "offset" that anti-competitive impact by giving new options to shippers somewhere else. New York respectfully requests that the Board clarify this principle in its final rules.

Finally, the Board should reconsider its apparent reluctance to adopt a more proactive posture in using its conditions authority to promote new competition in markets and regions dominated by a single, large carrier system. See NPR at 16-17. As New York showed in its initial Comments, the Board's handling of the issue of increased rail-to-rail competition east of the Hudson River in Finance Docket No. 33388 could serve as an instructive starting point for an expanded pro-competitive policy that would serve the public interest in increased competition as an effective counterweight to increased rail industry market concentration while stopping short of a "broad program of open access." See Comments at 8-9. New York urges the Board to take this opportunity to strike a more proactive, pro-competitive pose in its final version of proposed Section 1180.1(d).

II. THE PROPOSED RULE ADDRESSING PASSENGER-FREIGHT RAIL RELATIONS SHOULD BE ADOPTED, WITH CLARIFICATION

In its initial Comments, New York petitioned the Board to re-affirm its commitment to use its conditions authority to ensure the protection of publicly-funded passenger rail service in the context of any new major freight rail mergers or consolidations. See Comments at 11. New York noted the close tie between a vibrant passenger rail system and at least two (2) elements of the National Rail Transportation Policy,[5] and reinforced the connection between the Board's plenary authority over rail mergers and the successful co-existence of passenger and freight railroads on the lines and other facilities which they often share.

The Board's proposed rules respecting the preparation and submission of Service Assurance Plans by applicant carriers in future consolidation transactions include a provision specifically directed toward passenger rail interests. As set forth in proposed Section 1180.10(b):

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[5] Id.; 49 U.S.C. §10101(3) (safe and efficient rail transportation system); 49 U.S.C. §10101(14) (conservation of energy resources).

> If Amtrak or commuter services are operated over the lines of the applicant carriers, applicants must describe definitively how they will continue to operate these lines to fulfill existing performance agreements for those services. Whether or not the passenger services operated are over lines of the applicants, applicants must establish operating protocols that ensure effective communications with Amtrak and/or regional rail passenger operators in order to minimize any potential transaction-related negative impacts.

NPR at 35.

In general, the proposed rule adequately addresses the passenger rail-related issues raised by New York in its initial Comments, and should be adopted. However, the Board also should clarify that the mandatory reporting requirement will apply with respect to any line and over which both passenger and freight rail operations are conducted that is the subject of a proposed merger or consolidation transaction, without regard to whether the freight railroad is the owner of the line. Thus, for example, if a major freight railroad operates (or would operate) over a line owned by Amtrak or a public entity such as Metro-North Commuter Railroad Company, the carrier would be required to submit the same "definitive" description of the steps to be taken to accommodate passenger service as would be mandated under the proposed rule if the passenger authority were the tenant.

III. THE BOARD'S PROPOSED RULES MANDATING THE SUBMISSION OF SERVICE ASSURANCE PLANS REPRESENT REASONABLE REFORMS THAT SHOULD BE ADOPTED

A sampling of the many comments submitted in earlier stages of this proceeding reveals universal agreement regarding the importance of service quality and efficiency as priority considerations in evaluating any new rail mergers or consolidations. Moreover, there appeared to be basic consensus among virtually all parties (other than some of the major carriers themselves) that the Board's new merger rules should include meaningful and forceful mandates for the submission of data that would enable the agency to design and implement before-the-fact controls to avoid post-merger service disruptions. New York was among those advocating the adoption of new rules to require these "service impact" statements, as part of the overall transaction application and approval process. See Comments at 12-14.

The Board's NPR includes new rules (proposed Sections 1180.1(h) and 1180.10) that would require applicant carriers to submit comprehensive and detailed Service Assurance Plans covering all major aspects of anticipated post-transaction operations and resource allocations, including integration of operations; infrastructure improvements; information technology systems; customer service; and contingency plans for transaction-related service disruptions. See NPR at 35-36. Elsewhere, the

Board explains that applicant carriers will be required to address, inter alia, "how changes or increases in traffic levels would be accommodated by the combined system; and identif[y] [] potential areas of temporary or longer-term service degradation, and appropriate mitigation." Id. at 20. The Board indicates an intent to use the plans (and, presumably, comments thereon by interested parties) as "an important consideration in our determination as part of the balancing process of the likelihood of merger-related service harm and the possible need for mitigation." Id.

New York supports the new rules in proposed Sections 1180.1(h) and 1180.10, and urges that they be adopted in their entirety in the Board's final order in this proceeding. New York submits that in adopting the rules, the Board also should issue an unambiguous accompanying statement clarifying that Service Assurance Plans will be probative not only for the purpose of before-the-fact assessments of the need for mitigation conditions, but as benchmarks for measuring post-transaction performance during the oversight phase, when the Board retains jurisdiction to modify or impose new conditions in response to service challenges or more serious deficiencies. In any event, however, the Board should resist any calls to reduce the scope of matters to be addressed in a Service Assurance Plan, or in any

way weaken the role of the Plans in the approval process or the public scrutiny to which they would be subject.

New York also submits that in evaluating submitted Service Assurance Plans, the Board should give special attention and consideration to the interests of smaller communities and shippers. When post-merger service problems materialize, rural areas and those served by branch lines face the greatest risk from the de facto resource rationing that typically occurs. Especially in the areas of infrastructure, yard and terminal operations and contingency plans, the Board's final Service Assurance Plan rules should include special safeguards for rail-dependent smaller communities.

IV. THE PROPOSED RULES SHOULD BE EXPANDED TO BETTER PROTECT THE INTERESTS OF SMALLER RAILROADS

In the NPR, the Board proposed several rules changes which appear designed to advance or protect the interests of shortline and regional railroads. These include proposed Section 1180.1(c)(2)(ii), which promises Board consideration of "whether projected shifts in traffic patterns [resulting from a consolidation] could undermine the ability of the various network links (including Class II and Class III rail carriers and ports) to sustain essential services." See NPR at 15. In a similar vein, the Board's comment accompanying proposed Section 1180.1(h)

(service assurance and operational monitoring) outlines an expectation that future major transaction applicants will negotiate in good faith with their Class II and Class III connections over specific service assurances. Id. at 20. New York supports both of these changes to existing rail merger policy, and urges that they be adopted.

In contrast to the focus on shortline and regional railroad service impacts, however, the NPR essentially is silent on the need for reform in the area of artificial interchange barriers that foreclose competitive options for smaller carriers and their customers. As New York explained in its opening Comments (at 16), contractual conditions to line acquisition transactions which limit a shortline's interchange options artificially constrain both the shortline's growth and shippers' choices, to the detriment of both. As the Class I railroads have grown in size and market power through consolidations, the legitimacy of so-called "paper barriers" to competitive interchange has narrowed correspondingly. The Board's granting of relief to the Livonia, Avon & Lakeville Railroad in Finance Docket No. 33388[6] appeared to signal a new willingness to look critically at interchange barriers that had grown obsolete or no longer could be justified as alternative financing vehicles for

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[6] Decision served July 23, 1998 at 102-03.

new carrier line acquisitions. New York submits that the Board should expand and codify this approach, through adoption of a rule raising a rebuttable presumption in favor of the removal of Class II and III interchange barriers as a condition of approval of any new Class I mergers or acquisitions. See Comments at 17.

In the NPR, the Board expressed concern over suggestions by some that it should use its conditions authority more ambitiously to redraw the freight rail map:

> While the Board welcomes merger applications that propose to enhance competition by expanding access for shippers and Class II and III carriers, for example, we do not believe that it is appropriate for us in the first instance to attempt to use our broad conditioning powers to impose through merger approvals a broad program of open access....

NPR at 16. Whatever the merits of such a policy change, the issue of interchange barrier removal is far more narrow. The relief supported by New York would apply only to circumstances where feasible, effective physical interchange capability exists, but is precluded by contract terms that cannot be justified on competitive or financing grounds. In its initial comments in this proceeding, the American Short Line and Regional Railroad Association ("ASLRRA") called for an approach to the interchange barrier issue that relied in the first instance on negotiations between the affected carriers, but also included Board-mandated relief through conditions as necessary to ensure the removal of

"contractual barriers ... that prohibit or disadvantage full interchange rights, competitive routes and/or rates...." See Comments of ASLRRA, May 16, 2000 at 7. New York agrees that this approach properly balances the legitimate interests of large carriers, their smaller counterparts, and -- most important -- shippers and affected communities, in the face of further major railroad industry concentration. Consistent with its own earlier Comments in this docket, New York urges the Board to amend its final rules accordingly.

In addition to liberating smaller railroads from the strictures of anti-competitive interchange barriers, the Board's final rules should contain protections for shortlines and regional railroads from economic harm resulting from post-merger service failures. In many markets, the viability of a shortline depends on its ability to attract and retain traffic that requires effective and timely interchange service from a larger line-haul carrier. Class I service delays or equipment shortages during or following implementation of a major merger or consolidation can result in traffic diversions to motor carriage, with direct and disproportionately adverse economic consequences for the shortline. In its earlier comments, ASLRRA petitioned the Board to adopt a rule recognizing that "Class II and Class III railroads that connect to the consolidated carrier have the right to compensation by the consolidated carrier for service

failures related to the consolidation." Id. at 7. New York supports such a remedy for the protection of smaller railroads, and urges the Board to include it in the final rules.

V. THE BOARD SHOULD ADD ENFORCEMENT TERMS TO THE PROPOSED RULE REGARDING SCRUTINY OF CLAIMED PUBLIC BENEFITS

In the NPR, the Board appears to have heeded the call by New York and other interested parties for closer scrutiny of claims by merger applicants that a particular consolidation is justified by cost savings and efficiency gains expected to be realized as a result of the transaction. See, e.g., NPR at 10, 14. The disparity between such before-the-fact claims and actual, after-the-fact reality has been particularly clear and pronounced in the two most recent major rail consolidation transactions, with equally pronounced negative consequences for shippers and affected communities.[7] The new rule set out in proposed Section 1180.1(c)(1) represents a meaningful step toward reform of this deficiency in the current rail merger evaluation

[7] In the absence of a change in regulatory policy, the problem of inflated and unrealized merger benefits only could be expected to grow worse. As the Board acknowledged in the NPR, "[t]hrough mergers and other activities, railroads have now reduced most or all of their excess capacity, and have greatly improved the efficiency of their operations." NPR at 10. The reduced availability of additional efficiencies and cost savings from future mergers heightens the risk that forecasted public benefits from such transactions will not materialize.

system. In particular, New York supports requiring applicant carriers to develop and propose remedial measures to be taken in the event that claimed benefits do not materialize; i.e., that they be compelled to address the "what if" scenario. See NPR at 14.

While proposed Section 1180.1(c)(1) clearly is a move in the right direction, the absence of a specific enforcement provision and deferential reliance on carrier-crafted remedies could blunt its effectiveness as a deterrent to inflated claims by merger applicants. New York submits that the rule as proposed should be modified to include (1) confirmation that the Board will consider and, where appropriate, impose conditions proffered by parties other than applicant carriers to address the failure of claimed benefits to be realized on a timely basis; and (2) conditions precluding carriers from transferring the economic burdens of merger-related cost overruns to shippers and communities through rate increases or demands for public funding of needed infrastructure improvements, both of which represent problems squarely presented by the two most recent rail consolidation transactions approved by the Board. See F.D. No. 33726, Western Coal Traffic League v. Union Pacific Railroad Company, Decision served May 12, 2000; F.D. No. 33388 (Sub-No. 91), CSX Corporation, Et Al. -- Control and Operating

Leases/Agreements -- Conrail Inc., Et Al., First Submission by Applicants CSX Corporation and CSX Transportation, Inc., June 1, 2000 at 95-101.

CONCLUSION

New York commends its Comments to the Board's favorable consideration, and urges that its proposed modifications to the rules noticed for comment in the NPR be adopted.

Respectfully submitted,

THE STATE OF NEW YORK,
ACTING BY AND THROUGH THE
NEW YORK STATE DEPARTMENT OF
TRANSPORTATION

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Dated: November 17, 2000

CERTIFICATE OF SERVICE

I hereby certify that on this 17th day of November, 2000, I have served a copy of the foregoing Comments of the State of New York in Response to Advanced Notice of Proposed Rulemaking to be served on all persons designated as a Party of Record or Member of Congress by postage pre-paid, first-class United States Mail.

Kelvin J. Dowd